

IN THE UNITED STATES BANKRUPTCY COURT
IN AND FOR THE DISTRICT OF DELAWARE

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W.R. GRACE & CO., et al., : CHAPTER 11
Debtors : Case No. 01-01139 (JJF)
: Jointly Administered

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Wilmington, Delaware
Monday, November 5, 2001
4:33 o'clock, p.m.

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BEFORE: HONORABLE RODERICK R. McKELVIE, U.S.D.C.J.

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APPEARANCES:

PACHULSKI, STANG, ZIEHL, YOUNG & JONES
BY: DAVID W. CARICKHOFF, JR., ESQ.

-and-

KIRKLAND & ELLIS
BY: JAMES W. KAPP, III, ESQ. and
SAMUEL A. SCHWARTZ, ESQ.
(Chicago, Illinois)

Counsel for Debtors

PHILLIPS, GOLDMAN & SPENCE, P.A.
BY: JOHN C. PHILLIPS, JR., ESQ.

Counsel for Former Officers, P/3

Valerie J. Gunning
Official Court Reporter

ORIGINAL

1 APPEARANCES (Continued):

2 CAMPBELL & LEVINE
3 BY: MATTHEW ZALESKI, ESQ.

4 -and-

5 CAPLIN & DRYSDALE
6 BY: PETER LOCKWOOD, ESQ.
(Washington, D.C.)

7 -and-

8 BILZIN & SUNBERG,
9 SCOTT L. BAENA, ESQ.

10 Counsel for Official Committee of Asbestos
Property Damage Claimants

11 STROOCK AND STROOCK AND LAVAN
12 BY: KENNETH PASQUALE, ESQ.
13 (New York, New York)

14 Counsel for Committe of Unsecured Creditors

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P R O C E E D I N G S

(Proceedings commenced in the courtroom beginning
at 4:33 p.m)

THE COURT: Good afternoon, everybody.
Jack?

MR. PHILLIPS: Your Honor, Jack Phillips on
behalf of four former plaintiffs -- excuse me -- four former
officers and directors, the plaintiffs in this case.

This is the time set for the motion of those four
former officers and directors for indemnification, your
Honor.

We filed our motion. There has been a response
by the Committee for the asbestos personal injury claimants,
a response by the Unsecured Creditors Committee, and a
response by counsel for the debtors.

THE COURT: All right.

MR. PHILLIPS: Your Honor, this is a pretty
straightforward matter, in my opinion. These are former
officers, directors and agents of the debtor, but it goes
down to, I mean, Ryan is nothing more than a mid-level
person. He was the assistant comptroller. All four of these
people claim to have indemnification rights under the

1 by-laws, the by-law of the debtor corporation.

2 The by-law is cited to your Honor in papers.

3 All four of these people have, in addition to that,
4 contractual letters of indemnification from the
5 corporation. And but for the fact that an appeal was
6 taken of these SEC proceedings, this matter probably would
7 have been over and done with and these people would have been
8 paid and indemnified, but the appeal put everything on hold
9 and this filing has occurred.

10 But the fact is, your Honor, this is nothing more
11 than a strategic filing. The intent of this filing by this
12 debtor is to create a trust mechanism for paying asbestos
13 claims. I don't think it's a great secret. At the end of
14 the day, all the creditors are going to get 100 cents on the
15 dollar. At the end of the day, the asbestos plaintiffs are
16 going to get paid under the trust in accordance with the
17 trust provision. Providing the identification requested by
18 these four individuals will not adversely affect either of
19 those two groups of people.

20 The corporation itself was subject to this
21 investigation. The corporation itself took care of itself.
22 The corporation has depleted the only insurance policy that
23 would have been available to these people. So now when we go
24 ask for our insurance coverage, they say the policy is -- has
25 been used up.

1 And I suggest to your Honor that this is a
2 matter of equity that this Court has jurisdiction over.
3 These four -- well, at least three of these four people will
4 not be able to afford to defend themselves without this
5 indemnification.

6 These people are caught in a situation where the
7 accounting method at issue was reviewed and approved by the
8 Corporations Audit Committee and by the corporations outside
9 auditors. It was not an issue until the SEC changed its
10 rules.

11 And although these are serious allegations, they
12 are nothing more than allegations. These are not allegations
13 that have generated any shareholder derivative actions. It
14 is -- whenever this conduct was, it did not hurt the
15 corporation. It did not take money out of the corporation's
16 pocket.

17 Now, there's an argument to be made here, your
18 Honor, that the first-day motions, the employee benefit
19 motion, and perhaps thereafter the ordinary course motion
20 could allow this Court to order these indemnification
21 payments. Certainly, the Court's equitable power under
22 Section 105 would allow the Court to grant this motion, and I
23 suggest to your Honor that equity demands that this Court do
24 so.

25 I would also suggest, your Honor, that not doing

1 so would be detrimental to the estate. It would certainly
2 have negative publicity at a very sensitive time in this
3 debtors' reorganization process. But much more importantly,
4 I don't think it is -- I don't think there's any doubt, your
5 Honor, that this would cause debtors' current officers,
6 directors and managers serious concern at a time when it is
7 already difficult for a debtor to retain those people due to
8 the bankruptcy filing.

9 It would be detrimental to their morale and the
10 debtors' ability to retain these people. Thus, I think it
11 could be construed as a matter of necessity that the Court do
12 this in order to protect that morale and the retention
13 efforts. And I would suggest to your Honor that the Debtors
14 Committee -- excuse me -- the debtors actually support this
15 motion and, as a consequence, I believe the Court should
16 grant this motion.

17 THE COURT: All right. Who else wants to speak
18 today?

19 MR. PASQUALE: Good afternoon, your Honor. Ken
20 Pasquale for the Official Committee of Unsecured Creditors.

21 I think we'd agree that this is a straightforward
22 matter. However, it's straightforward because the law that
23 governs this motion compels the result, which is that the
24 motion should be denied.

25 The by-laws and the letter indemnification

1 agreements were all entered into prepetition. The acts that
2 are involved are all prepetition. None of the former
3 employees were employed at any time near the petition date,
4 and certainly not post-petition.

5 These are prepetition, general unsecured claims.
6 And we've cited the cases in our pleading to the Court in
7 this circuit that provide that indemnification requests like
8 this are prepetition claims, not entitled to any priority
9 treatment, which is exactly what's being asked for here:
10 Priority treatment.

11 Nor is this a matter where Section 105 and the
12 equities should be applied.

13 The cases in this circuit, the Lehigh case that
14 we've cited, under the necessity doctrine, payment has to be
15 necessary to facilitate the continued operation of the
16 debtor. We don't have any of that here. This is not the
17 type of situation where we have a trade, a vital trade
18 creditor, for example, that can impose what's -- an economic
19 sanction upon the debtor. These are former employees looking
20 for indemnification payments.

21 There is a heavy burden upon the movants in the
22 situation, in any event. And I think looking at the papers
23 and what has been presented today, the movants haven't met
24 that burden. We hear words, but they certainly can't meet
25 the burden of an economic impact upon the debtors

1 post-petition in the reorganization process.

2 Finally, let me just say, with respect to the
3 first-day orders, the debtors, in their own submission to
4 this Court on this motion, have admitted that, first, the
5 ordinary course motion was denied, so there's no relief to be
6 gained there.

7 With respect to the employee benefits motion, the
8 debtors admit that that motion was not intended to cover
9 these former employees and these requests for
10 indemnification.

11 And, indeed, the Committee objected to the
12 employee benefit motion with respect to payments to former
13 employees, and certainly had that motion pertained to these
14 former employees, we would have objected there as well.

15 But I think the most important factor there is
16 that the debtors say, and they admit that it was not their
17 intention to cover these employees by those motions. And,
18 certainly, the orders that were entered are totally silent
19 as to it.

20 Finally, with respect to the debtors' papers
21 to this Court on this motion, the debtors say, Well, it's
22 okay with us because we have the money. Well, I think all of
23 the creditors in my constituency, the banks and the trade,
24 they'd love to get paid now, too. But that's not what the
25 bankruptcy laws provide. And this is no different. There's

1 simply no legal justification to grant this motion.

2 Finally, with respect to the impact that this
3 could have on the debtors, it has been seven months since the
4 debtors filed the petition. I think by now, the employees,
5 current employees, especially in light of the first-day
6 orders, they now have more of an understanding of what this
7 process will mean to them.

8 And, frankly, denying this motion will have no
9 impact, it seems to me, to any of those employees. We're
10 talking about four people in the scope of the larger
11 first-day orders that were entered by the Court to protect
12 employees.

13 So we submit that the motion should be denied.

14 THE COURT: All right.

15 MR. PASQUALE: Thank you.

16 THE COURT: Anyone else?

17 MR. LOCKWOOD: Good evening, your Honor. No. It
18 is still afternoon. Peter Lockwood from Caplin Drysdale for
19 the Asbestos Claimants Committee.

20 I would just like to respond to a couple of
21 points made by counsel for the movants here. The -- with all
22 due respect, the assertion that this is sort of a trivial
23 exercise because there's not a lot of money and this is just
24 a strategic filing and we're going to put money in a trust,
25 everything is going to be paid off a hundred cents on the

1 dollar that was made at the beginning of the argument there,
2 there's an expression I believe called his mouth to God's
3 ear.

4 I think, suffice it to say that while it is
5 devoutly to be hoped that that might be the outcome here,
6 there is certainly nothing in the record to date that
7 would support the substantial likelihood of such an outcome,
8 and I would submit that this Court could not possibly,
9 absent the creation of some sort of record on the point,
10 simply take counsel's naked assertion that such a result was
11 likely to be forthcoming as a basis for granting a motion of
12 this sort.

13 And, indeed, I think the absence of a record is
14 of some significance here, because there are a number of
15 other assertions that have been made here that conceivably,
16 had they been the subject of evidence, the Court might be
17 entitled to take them into consideration.

18 For example, the assertion that there would be
19 negative publicity to the company that would be in some sense
20 meaningful is just an assertion. There's no showing of
21 that. The papers do indicate that the corporation, as we
22 pointed out in our opposition, was, in fact, sued because of
23 the acts of the -- with which the SEC also charged the
24 individual plaintiffs here. The corporation settled that
25 case many years ago.

1 We don't -- they assert that their acts didn't
2 cause any harm to the corporation. It didn't cost it any
3 money. Well, we don't have the record of whose
4 responsibility it was or what the terms of the settlement
5 were or how much legal fees the corporation had to pay in
6 order to arrive at the settlement that it did, but, again,
7 the notion that we could just toss out hear the proposition
8 that, Oh, gee, the corporation never got heard, and that's
9 another reason why equity should suggest that these amounts
10 should be paid.

11 As Mr. Pasquale pointed out, these are
12 indisputedly prepetition claims that are at issue here, and
13 the only bankruptcy principle that would, or there may be two
14 bankruptcy principles that might, under a proper showing,
15 take prepetitions and allow them to be -- prepetition
16 obligations and allow them to be paid post-petition.

17 One is the necessity doctrine, which Mr. Pasquale
18 averted to. The necessity doctrine, because it allows a
19 debtor to prefer certain types of prepetition claims over all
20 other types of prepetition claims, by paying them currently,
21 is a very, very narrowly limited doctrine, and it is
22 predicated on the proposition that the relationships between
23 the debtor and the creditors whose claims are being paid are
24 so important to the continued financial success of the debtor
25 during the reorganization process post-petition, that it is

1 in the interests of the debtor and all of its existing
2 creditors that those claims be paid so that those
3 relationships can be preserved.

4 There is no relationship between this debtor
5 and these creditors to preserve, and the doctrine of
6 necessity is accordingly wholly inapplicable under these
7 circumstances.

8 The only other suggestion of any kind of
9 continuing impact on the debtor is the supposition that
10 somehow or another, because these former officers have
11 indemnity claims that might not get paid, that would make the
12 current officers afraid that if they had indemnity claims in
13 the future, they might not get paid.

14 Well, among other things, there would certainly
15 be at least the substantial possibility that if there were
16 actions that could successfully be asserted against present
17 management post-petition, that those actions would not be
18 prepetition claims, if indemnification was sought. Even if
19 you could argue that the right to indemnify was a prepetition
20 origin, because it was based, say, on the by-laws that
21 existed prepetition, the fact would remain that the current
22 officers could, in fact, come in here and make an argument
23 under the doctrine of necessity that they were necessary to
24 the corporate reorganization and that their being unable to
25 defend themselves would somehow or another hurt this

1 corporation as it exists today in this reorganization and in
2 its present business, an argument which is wholly
3 inapplicable and unavailable to former officers.

4 So there's just no -- there's no equity and no
5 legal basis for the Court to do here what these debtors --
6 what these movants would ask it to do.

7 Their final resort is, Gee, Judge, we're really
8 going to be in tough shape financially if we don't get
9 indemnified.

10 I will accept counsel's naked assertion of that
11 as truthful. But the fact is that I represent a lot of
12 people, some of whom are dying from mesothelioma, or lung
13 cancer, and they're not going to get paid anything on their
14 prepetition obligations while this case is going on. And for
15 the life of me, I would have a tough time explaining to them
16 and their families why their needs are any less entitled to
17 special attention from this Court than the financial needs of
18 somebody whose prepetition conduct has gotten it embroiled in
19 litigation with the SEC, litigation which, I might add,
20 presumably they could have settled just like the company did
21 many years ago, and this would not be before us today.

22 Thank you, your Honor.

23 THE COURT: Anybody else?

24 MR. KAPP: Good afternoon, your Honor. James
25 Kapp on behalf of the debtors.

1 I thought I might say a few words. I've heard a
2 lot of talk about what the debtors had to say, so I thought
3 I'd stand up and repeat some of this.

4 Two points, your Honor: One, the debtors don't
5 dispute that they have this obligation, and also if required
6 to do so today, we do have current assets to satisfy those
7 obligations currently.

8 We do believe, however, that as of today, we do
9 not have the authority to make those payments without
10 authority from this Court.

11 As was said, the ordinary course motion was
12 denied. That order, we should not rely on that order.

13 As to the wage motion, it does not -- was never
14 intent and does not expressly include what's being sought
15 today.

16 Really, it's a matter of timing, and, obviously,
17 the debtors are very concerned about morale of their current
18 employees. If there was a demonstration that this sort of
19 thing would impact morale of current employees and led
20 current employees to believe that their indemnification
21 rights may, for some reason, be threatened by what goes on
22 here today, we would be inclined to support this motion.

23 Thank you.

24 THE COURT: Okay.

25 MR. PHILLIPS: Your Honor, just briefly, as I

1 said, I think the debtor does, in fact, support this motion.
2 The debtor acknowledges its obligation under the contract and
3 the by-laws, and with regard to Mr. Lockwood's statement,
4 this petition was only filed in 2001.

5 There is a lot of time left on statute of
6 limitations for things that preceded that. That it could, in
7 fact, be prepetition claims as he would have you believe.
8 That would, indeed, impact current management, current
9 officers, who are entitled to indemnification.

10 This Court, as it does in every filing, always
11 hears from debtors' counsel how it is important to employ and
12 retain executives, how difficult that is. It often asks for
13 special compensation packages.

14 I would suggest to you, your Honor, that a
15 showing of necessity has been made. It is important to this
16 debtor, as debtors' counsel has just acknowledged, that it is
17 able to retain its executives, that that would be
18 jeopardized, and there is a financial or economic impact, all
19 of the retention efforts to date would be wasted.

20 This is something that I am sure the Court is
21 aware is significant to officers and directors. They're very
22 mindful of the fact that they could be named as individual
23 defendants in matters that, for which they would rely, as
24 these four people relied in good faith on their right to
25 indemnification.

1 And it would impact this debtor. It would impact
2 their ability to retain these executives, and that would
3 obviously have economic impact on this debtor.

4 And beyond a doubt, this Court has economic --
5 excuse me -- has equitable power to grant the relief
6 requested, and I would request that you exercise that power
7 and do so.

8 THE COURT: All right. Having heard
9 the arguments, I've decided I'm going to deny the motion.

10 I don't think the application falls within the
11 narrowness doctrine, and I don't see why these employees
12 should be treated differently than other creditors, but I do
13 hope that the statement is correct, that all the unsecured
14 creditors will get paid a hundred cents on the dollar, and
15 that these employees will get paid on their indemnification
16 claim as promptly as they can be paid.

17 All right. Is there anything else to take care
18 of?

19 MR. PHILLIPS: Nothing, your Honor.

20 THE COURT: Good. Court is in recess.

21 (Court recessed at 4:55 p.m.)

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I hereby certify that the foregoing is a true
and accurate transcript from my stenographic
notes in the proceeding.

Valerie J. Lundy

Official Court Reporter
U.S. District Court